MEASURING OUR GROWTH

1999 Q·MEDIA SERVICES CORPORATION ANNUAL REPORT

COMPANY PROFILE

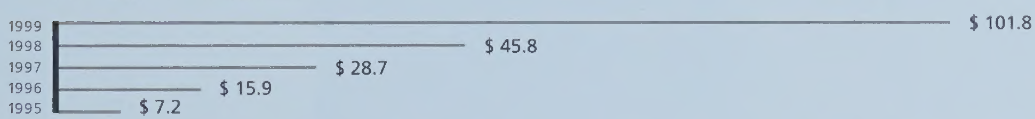
Q•MEDIA PROVIDES SUPPLY CHAIN MANAGEMENT SOLUTIONS TO NORTH AMERICA'S LEADING SOFTWARE PUBLISHERS AND HARDWARE MANUFACTURING COMPANIES. Q•MEDIA'S "JUST-IN-TIME" SERVICE INCLUDES MEDIA REPLICATION, MATERIALS PROCUREMENT, PACKAGE ASSEMBLY, INVENTORY MANAGEMENT AND ORDER FULFILLMENT.

Q•MEDIA HAS REGIONAL OPERATIONS IN VANCOUVER, BC; SEATTLE, WA; NEWARK AND IRVINE, CA; AUSTIN, TX AND NASHVILLE, TN. SHARES OF Q•MEDIA TRADE ON THE TORONTO STOCK EXCHANGE UNDER THE SYMBOL QMS.

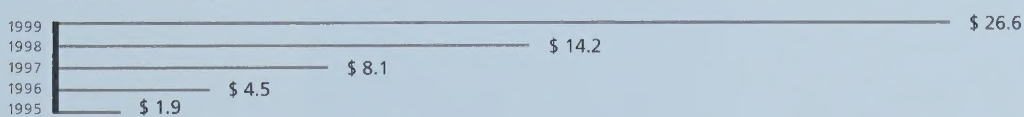
HIGHLIGHTS

- Five year revenue growth of 4,857%.
- 1999 revenue growth of 122% to $101.8 million.
- An 84% increase in EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) to $10.4 million.
- CD-ROM capacity increased from 27 million to 42 million annually; CD mastering installed.
- The Company added Dell Computer Corporation as a meaningful customer in 1999.
- Through a buyback of special warrants the Company reduced its fully diluted shares by 1,139,440 or 6.3%.
- New regional facility added in Nashville, TN.
- Successful integration of Irvine and Seattle operations acquired in fiscal 1998, including improved results.
- Substantial improvements in infrastructure and management resources to prepare for continued growth.

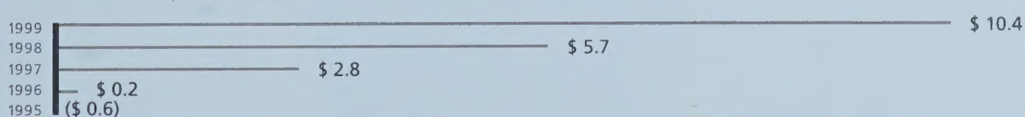
REVENUE (IN MILLIONS)



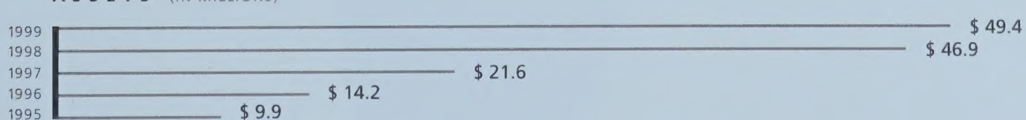
GROSS MARGIN (IN MILLIONS)



EBITDA (IN MILLIONS)



ASSETS (IN MILLIONS)



R | E | V | E | N | U | E

Q•MEDIA'S EXCELLENT PERFORMANCE IN FISCAL 1999

CAPPED FIVE YEARS OF OUTSTANDING GROWTH.

ANNUAL REVENUES HAVE GROWN FROM $2.1 MILLION

IN FISCAL 1994 TO OVER $100 MILLION THIS YEAR.

1999	1998	1997	1996	1995
$101.8	$45.8	$28.7	$15.9	$7.2


101.8
45.8
28.7
15.9
7.2

LETTER TO SHAREHOLDERS

YOUR COMPANY'S EXCELLENT PERFORMANCE DURING FISCAL 1999 CAPPED OFF FIVE YEARS OF OUTSTANDING GROWTH FOR Q•MEDIA. AS A RESULT OF A HIGHLY POSITIVE COMBINATION OF INTERNAL GROWTH AND EXTERNAL, ACQUISITION-DRIVEN EXPANSION, REVENUES HAVE GROWN FROM $2 MILLION FIVE YEARS AGO TO JUST OVER $100 MILLION. AS WOULD BE EXPECTED, THIS ACHIEVEMENT HAS ALSO CREATED MANAGEMENT CHALLENGES. ACCORDINGLY, DURING FISCAL 1999, MEANINGFUL INVESTMENT WAS MADE IN BUILDING THE INFRASTRUCTURE AND PEOPLE RESOURCES NEEDED TO GROW THE COMPANY SUCCESSFULLY TO THE NEXT LEVEL. THE GOOD NEWS IS THAT THE OUTLOOK FOR THE NEXT FIVE YEARS IS EQUALLY POSITIVE AND MANAGEMENT'S ATTENTION IS FIRMLY FIXED ON LEADING THE COMPANY TO ACHIEVING MORE RECORD RESULTS.

Q•Media's sales performance in fiscal 1999 surpassed analyst forecasts by about 25%. Revenues topped the $100 million mark, an important milestone, up 122% from fiscal 1998. Your Company also produced a strong showing in EBITDA (earnings before interest, taxes, depreciation and amortization), which increased 84% to $10.4 million. Net earnings were $4.5 million.

We believe that these record results are a result of the Company's main strategic focus, which is to always put the customer first. Increasingly, the industry is coming to recognize that Q•Media is known for being responsive, accurate, fast and customer-focused. This is becoming more important as the software and hardware industries continue to evolve and become even more competitive. With product cycles becoming shorter and time to market assuming critical importance, Q•Media's one-stop outsourcing model is becoming very popular.

Q•Media not only manages manufacturing, packaging and delivery of our customer's products, more importantly, we manage time for them. The Company's strong growth performance has also proven the wisdom of its decentralized, regionally focused operating structure. Q•Media locates its facilities close to the Company's major customers. In two cases our relationship with our customer is so intimate that we deliver software kits directly to their assembly lines, just-in-time, for bundling with their hardware components. This level of integration is win/win. Our customers become more competitive by reducing product cycles and reducing inventory to almost nil. We win by getting bigger and bigger chunks of their business.

The Company is currently in the process of setting up a new facility in Nashville, Tennessee, which will include CD-ROM manufacturing. This is in direct response to a perceived need by one of Q•Media's large customers. The Nashville location gives the Company a new geographic base and allows us to expand service to this major hardware manufacturer, which we also will continue serving in Austin, TX.

I am pleased to report that other major internal expansion projects designed to serve our customers better have just been completed at our Vancouver-area location. The Company's head office and Vancouver manufacturing and service operations were moved from East Vancouver to a larger, built-to-suit facility in the Vancouver suburb of Richmond. Installation of CD manufacturing took place at the same time at the new facility. The Vancouver installation and planned Nashville capability will bring the Company's overall annual capacity to some 42 million CD-ROMs up from 27 million last year. Commercial production at Vancouver commenced in late September.

The ongoing expansion of CD-ROM manufacturing has prompted another important improvement—the addition of previously outsourced CD mastering. Addition of this service allows Q•Media even tighter order turnaround since we will control more of the process. Initially, this one CD mastering unit at Vancouver with annual capacity of 14,000 masters, is servicing all of the Company's facilities.

Building the infrastructure to support Q•Media's ongoing rapid growth was a key focus in fiscal 1999, with special emphasis on our newest acquisition in Irvine, CA. During the year, the Company upgraded Irvine's

backoffice systems to integrate it with Q•Media's other facilities and allow more rigorous controls and reporting. There were some growing pains over the year at Irvine, however I am pleased to report that operations were much improved by year-end and that overall this new business unit performed well, especially considering Irvine volumes were higher than expected.

A significant innovation developed by Q•Media in fiscal 1999 will help improve customer service and takes the Company into the next generation of technology solutions. In conjunction with a major software developer, an Internet-based ordering, fulfillment and inventory-tracking system was developed in Irvine and received highly positive customer reviews in testing over the spring and summer months. This capability allows customers to place orders as well as track order progress and their inventory in our warehouse in an easy-to-use, on-line environment. We anticipate rolling out this system in at least one of our other locations during fiscal 2000.

Your Company's management has watched the growth of new technologies and new media with close attention, and will continue to do so going forward. To date, the development of the Internet has been positive for Q•Media. It has produced a new software segment, Internet-related software, which is primarily distributed in boxes. Just as significantly, it is enabling us to provide improvements to customer service.

On the media front, we have responded to a significant shift from diskettes to CD-ROM. There has been no significant demand from our customers yet for DVD-ROM (Digital Versatile Disk-Read Only Memory). As the Company did with CD-ROM, we will outsource demand initially until there is sufficient volume to justify upgrading our facilities. In the case of DVD, the upgrade is relatively straight forward and inexpensive. As the media for software, film and music continue to converge, Q•Media will be watching developments carefully for opportunities for continued expansion of sales and profits.

The Company's solid financial position allowed it to reduce potential share dilution by 6% during fiscal 1999 through a $3 million buyback of special warrants. Q•Media remains in a strong position for continued expansion, with low debt, solid working capital of $8.2 million and unused lines of credit of $12 million.

In a further move to equip the Company to move to the next level, a new member was appointed to the Board in the summer of 1999. We are pleased to welcome Robert S. Cecil to the Board. His strong background includes boosting the operating performance of high tech companies through a concentration on quality customer service and management systems.

Q•Media has been enriched by the input of our three retiring board members, David Rae, Catherine Boshaw and Edmond Lemieux and we thank them for their dedicated efforts on behalf of all shareholders. In particular, our first Chairman, Ed Lemieux was instrumental in advising the Company through its formative stages and provided important contributions in securing our initial equity offerings and strategic decisions. For his good and faithful service we will always be indebted.

Your Company's future remains very bright. Q•Media is in a growing industry and continues to have excellent acquisition opportunities. We expect our operations to post strong revenue and profit growth in fiscal 2000.

On behalf of the Board,

Robert M. Lawrie
President & CEO
October 5, 1999

G R O S S M A R G I N

DISCIPLINE IN THE OPERATION OF OUR BUSINESS

WAS KEY TO IMPLEMENTING LOWER COSTS AND MORE

EFFICIENT SOLUTIONS FOR OUR CUSTOMERS.

1999	1998	1997	1996	1995
$26.6	$14.2	$8.1	$4.5	$1.9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D.B.P. – DESIGN – PAT.
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Q•MEDIA PRODUCED A STRONG SHOWING IN EARNINGS BEFORE INTEREST, TAXES, DEPRECIATION AND AMORTIZATION, WHICH INCREASED 84% TO $10.4 MILLION.

1999	1998	1997	1996	1995
$10.4	$5.7	$2.8	$0.2	($0.6)


10
11
12

REVIEW OF OPERATIONS

GROWTH HAS BEEN BOTH THE SUCCESS AND THE CHALLENGE OF Q•MEDIA'S OPERATIONS. THE COMPANY'S EXPANSION AND CHALLENGES HAVE RESULTED FROM THREE PRINCIPAL FACTORS:

- THE ONGOING TREND OF OUTSOURCING OF MANUFACTURING OPERATIONS BY HARDWARE AND SOFTWARE COMPANIES IN MARKETS CONTINUING TO EXPERIENCE DOUBLE-DIGIT GROWTH.
- THE COMPRESSION OF PRODUCT CYCLES, WHICH HAS DEMANDED A HIGHLY DISCIPLINED AND FOCUSED APPROACH TO SERVING THE HARDWARE AND SOFTWARE MARKETPLACE.
- THE CORPORATE RESOURCES – CAPITAL, ORGANIZATION, INFRASTRUCTURE – TO NOT ONLY RESPOND TO, BUT EXPLOIT, THE OPPORTUNITIES INHERENT IN THIS DYNAMIC MARKETPLACE.

AGAINST THIS BACKDROP OF AN EXPANDING MARKETPLACE, INCREASING DEMANDS FROM OUR CUSTOMERS, AND A CONTINUING MANAGEMENT FOCUS ON A DISCIPLINED, EFFICIENT ORGANIZATION, WE CONTINUE TO GROW.

GROWING WITH OUR CUSTOMERS

1999 was an exceptional year, in a large part due to the continued robust growth being experienced by our customers. The personal computer industry is a fast paced environment that is unforgiving to companies that do not respond quickly to the evolving marketplace. At Q•Media we have been fortunate to partner with a number of leading technology companies. Two of our customers, Dell and Toshiba, continue to experience substantial success in their markets and are arguably the leading suppliers in their respective market segments. Our focus for these types of customers is to continue to respond to their current needs and develop our organization and infrastructure in anticipation of their future requirements.

This focus has led us to develop a unique, decentralized business model, designed to enhance customer communication and customer-centered service. In 1999, we expanded this "service-orientation" in four significant ways. First, we established CD-ROM manufacturing at Austin, TX to reduce Dell's order turnaround on CD-ROM products and have designed a process that allows us to deliver new titles to their assembly lines within 24 hours of release of the title. Second, at Irvine, CA we established a new JIT (Just-in-Time) program for the delivery of hard drives from a major manufacturer to Toshiba. Third, we established a new facility in Nashville, TN to service Dell's new manufacturing operations being established at Nashville. Ultimately, our goal is to foster lasting, mutually beneficial partnerships with customers, where Q•Media assumes a quasi-internal department within the customer's organization, thus enabling the Company to deliver unmatched service levels.

Late in fiscal 1999, a new location for our Vancouver operation was established. This new building was built, in part, to accommodate the installation of a new CD-ROM mastering suite. This key investment, which creates the "stampers" from which CD-ROM's are manufactured, has been instrumental in reducing our turnaround times and increasing customer service at all of our locations. Customer service of uncompromising quality, being the concentration of Q•Media's growth, continues to dominate the choices made by the Company in strengthening its operations.

MANAGING BY SYSTEMS

In order to efficiently and effectively manage our growth, 1999 was a year which featured enriching and expanding our infrastructure and business processes. Our philosophy with developing our infrastructure has always been to "grow into new systems and processes", not "impose an infrastructure". Our second principle with respect to infrastructure has been to insist on "scalability" to service our growth and "transportability" to respond to our decentralized structure. As our range of services for our customers has grown, we have carefully developed and implemented new systems and processes to respond to our customers' expanding needs.

We entered 1999 with the immediate challenge of replacing the information system at our newly acquired Irvine facility. In particular, we installed a new MRP II system which we will begin to exploit at our other locations, thus enriching our corporate infrastructure for all of our customers. We re-trained 50 staff members on the new information system. All of this had to occur in an environment where customer shipments are being made every two hours, on eight hour notice, 20 hours per day. It is a credit to our Irvine based staff and corporate MIS team that the installation went live in January without compromising customer shipments.

Concurrent with the new system at Irvine, our manufacturing group installed new state of the art CD-ROM manufacturing equipment at our Austin and Seattle facilities. This new equipment allowed us to implement lower cost, more efficient manufacturing solutions for our customers and also increase our ability to respond to production level loading across multiple facilities. In an industry that is culturally oriented to bringing work from customers to one central location and then returning it to the customers, we consistently surprise our competition with our ability to move the production resource close to the customer thereby increasing the ability of our customers to effectively execute their business.

In late fiscal 1999 we completed initial customer trials with our new Internet-based order entry, order status and fulfillment system. Our next step will be to roll-out this service to provide all of our customers with direct, real-time access to all of the information concerning their orders. Our aim with this system is ambitious! This is the first step in developing a complete Internet-based systems infrastructure with comprehensive electronic commerce and order tracking capability — right to the consumers' door. Our challenge in the next year is to complete a measured roll-out that not only enriches our customer relationship but continues to expand our services coincident with our customers evolving requirements.

SERVING THROUGH PEOPLE

In ensuring continuity of the value Q•Media brings to its customers, the development of an effective organization and management group has been key during our period of rapid growth. In short, our organizational capabilities are the key determinant in driving the pace of our growth. Our people are not only challenged with enhancing our service capabilities to our customers but also responding to an evolving marketplace and rapid growth that has seen the Company approximately double in revenue every year for the last five years.

Building on initiatives begun in 1998, significant organizational and management systems change occurred in 1999. First we added two new executive positions; Vice President, Sales and Marketing and Vice President, Finance. These positions have given us increased focus in developing key functional areas of sales, accounting, and information systems; all key areas to the Company's immediate future. From this focus, 1999 was the first year that each operation assumed direct responsibility for operating and capital budgets. In addition, at the divisional level we instituted new management decision making processes to speed effective decision making and enhance timely assessment of new opportunities.

In order to broaden our management group, we re-deployed a number of key personnel at the divisional level. Our objective was to increase our organizational capabilities in key areas of growth and customer demand. With an eye to continued growth and increased customer requirements, we also appointed two key operational leaders at two divisions. Finally, at the close of our fiscal year, we announced the appointment of Robert S. Cecil to the Company's Board of Directors. Mr. Cecil brings invaluable experience in marketing, sales, and operations with a variety of companies including Fortune 500, start-up and turn around situations.

As we continue to develop and enhance our organizational and management resources, our focus remains anchored on ensuring responsiveness to the dynamics of our market, flexibility in meeting our customers' needs, and discipline in the operation of our business.

A S S E T S

A SMALL CHANGE IN Q•MEDIA'S ASSET BASE

GREW REVENUE 122% TO $101.8 MILLION AND

OPERATING EARNINGS 94% TO $6.2 MILLION.

1999	1998	1997	1996	1995
$49.4	$46.9	$21.6	$14.2	$9.9

OUTLOOK

In producing ongoing growth at Q•Media, we will continue implementing the Company's long-term strategy of acquiring, through a rigorous selection process, companies that will reinforce Q•Media's presence in existing regional markets and serve as logical geographical extensions. In addition to building the bottom line, other criteria that potential acquisition targets need to bring to the table include diversification of Q•Media's customer base and management talent. The software manufacturing industry in North America continues to offer many opportunities to a consolidator such as Q•Media. The capital investment required of traditional software manufacturers to sustain viable operations has increased significantly and many smaller players are finding themselves under increasing market pressure. Q•Media's size and profitability in the marketplace of software manufacturers are ideal in placing it among the few consolidating forces in the North American industry today.

M | E | A | S | U | R | I | N | G   U | P

1999 Q•MEDIA SERVICES CORPORATION FINANCIALS

MANAGEMENT DISCUSSION AND ANALYSIS

(IN THOUSANDS OF DOLLARS)

OVERVIEW

This discussion and analysis should be read in conjunction with the audited consolidated financial statements and accompanying notes of Q•Media Services Corporation ("Q•Media" or the "Company") for the respective year.

FINANCIAL CONDITION

There was significant growth and financial improvement in the Company during fiscal 1999. Total tangible assets grew from $28,510 to $31,932 during fiscal 1999. Shareholder's equity increased during the year from $20,527 to $21,719. Working capital improved to $8,165 in 1999 from $5,279 in 1998. The working capital ratio improved to 1.59 to 1, compared to 1.38 to 1 in fiscal 1998. The debt to equity ratio was 1.27 to 1 in fiscal 1999 compared to 1.29 to 1 in fiscal 1998.

RESULTS OF OPERATION: FISCAL 1999 AS COMPARED TO FISCAL 1998

The 1999 results include the Canadian software manufacturing division (formerly Quorum) and U.S.-based PAC Services (California), Inc. ("PAC California", formerly Genisys Digital Systems, Inc.) of Newark, California; Q•Technology Services, Inc. ("Q•Technology") of Woodinville, Washington; Digimedia, Inc. ("Digimedia") of Austin, Texas; PAC Services, Inc., of Redmond, Washington ("PAC Washington") and Q•Media Services, Inc. of Irvine, California ("QMSI").

Sales for fiscal 1999 were $101,843 compared to $45,801 for fiscal 1998, a 122% increase. The increase is primarily due to acquisitions made in July of fiscal 1998. Pricing for the Company's products and services has remained stable in the year.

Gross profit for fiscal 1999 was 26.2% compared to 30.9% for 1998. The reduction in gross profit was due to the impact of QMSI on fiscal 1999, as this operation has a high content of pass-through materials, thereby lowering the gross profit. Only one month of QMSI's results was included in fiscal 1998.

As a percentage of sales, general and administrative expenses improved to 10.1% from 11.7% in 1998. General and administrative expenses increased from $5,352 to $10,268 for fiscal 1999, which was the result of the inclusion of a full year of general and administrative expenses of QMSI totaling $2,191 for the year.

As a percentage of sales, selling expense improved to 5.8% from 6.8% in fiscal 1998. Selling expenses for fiscal 1999 were $5,921 compared to $3,132 for fiscal 1998. The increase in selling cost is largely attributed to a full year of operations of QMSI totaling $1,712.

Interest expense in 1999 was $1,339 compared to interest expense of $557 in 1998. The increase in interest expense was due to increased use of the Company's operating lines of credit during fiscal 1999, partly due to the interest on the US $2,000 term loan secured in March of 1999 to redeem special warrants, and partly due to a full year of interest expense on the $10,000 Convertible Debentures issued by the Company on December 23, 1997.

Amortization for fiscal 1999 was $2,949 compared to $1,894 for fiscal 1998. This increase is the result of on-going amortization of capital assets and goodwill as part of normal operations. Amortization in fiscal 1999 included goodwill amortization of $868.

Net earnings for fiscal 1999 were $4,501 compared to a net loss of $4,937 for fiscal 1998. The net loss in fiscal 1998 included a write-down of goodwill and investments of $8,143. Basic earnings per share were 43 cents and fully diluted earnings per share were 30 cents in fiscal 1999, compared to basic loss per share of 54 cents in 1998.

Funds flow from operations before changes in non-cash working capital items for 1999 was $7,668 compared to funds flow from operations of $5,219 for fiscal 1998. The improvement in funds flow from operations is attributable to the addition of the PAC Washington and QMSI operations, and the improved profitability of Digimedia. The Company used $3,356 in cash and cash equivalents during 1999, compared to an increase in cash and cash equivalents of $3,600 in 1998. The change in cash flow in 1999 compared to 1998 is attributed to the increase in non-cash working capital to support the increased volume of operations.

The July 31, 1999 working capital was $8,165 compared to $5,279 in 1998. Accounts receivable increased to $12,732 from $10,037 which reflects the increase in revenues during 1999. Inventory levels increased to $6,397 at July 31, 1999 compared to $4,432 at July 31, 1998, as a result of the increase in sales volumes of 122%. Accounts payable were $11,878 compared to $11,884 in 1998. At July 31, 1999 the Company had an un-utilized operating line of credit of $12,096 (US$8,000). At year-end, capital lease obligations were $1,493 in 1999, down from $2,148 in 1998.

LIQUIDITY AND CAPITAL RESOURCES

During the next year, debt and capital lease payments are expected to total $2,072 compared to $2,119 in fiscal 1998. Funding for these payments is expected to be provided from operating cash flow.

Capital asset purchases were $2,787 in fiscal 1999, compared to $1,776 in 1998. The Company continued to invest in manufacturing machinery and equipment, CD replication equipment, and computer hardware and software.

Long-term cash requirements for expansion of the Company will be satisfied through a combination of operating cash flow, the operating line of credit and debt and equity financing.

RISKS AND UNCERTAINTIES

The software manufacturing industry is undergoing a change in technologies as its customers move from the traditional magnetic media to optical media. In addition, the industry is subject to changing industry standards and customer preferences. While Q•Media is confident that its product and service offerings will remain competitive, there is no assurance that new service requirements, technologies or customer preference will not adversely affect the market for its service.

The Company endeavors to mitigate the negative impact of technology change by continuing to invest in a broader range of offerings to its customers. This has been evident in 1999 with the additions of three new CD-ROM replication facilities and the design of those facilities to accommodate future technological advancements in optical media replication. In addition, the Company invested in information systems including materials requirements planning (MRP) and electronic fulfillment systems.

The Company's management has conducted a review of Q•Media's exposure to the Year 2000 computer issue. Currently, the Company uses "industry standard" software in its office and information system functions which are Year 2000 compliant. The software employed in its CD manufacturing process is Year 2000 compliant. The software used to run the Company's diskette duplication equipment has been tested to assess what upgrades may be required. In addition the Company has assessed the Year 2000 readiness of certain key suppliers and is implementing contingency plans to minimize the impact from key suppliers. As a result, the management of Q•Media believes that the Year 2000 issue should have no material impact on the Company's operations.

OUTLOOK

During 2000, the Company will continue to focus on adding CD replication and CD mastering services and increase the sale of these services to its existing customer base. In addition, turnkey manufacturing services and electronic fulfillment services are expected to grow as a greater portion of our customers are requiring a full range of services including the procurement of materials on their behalf.

During 1999, the Company extended efforts to integrate acquisitions completed in 1998. Having largely completed this activity and given the continuing consolidation of the software manufacturing industry, the Company is positioned to acquire further operations. Although there is no certainty in the outlook of the results for fiscal 2000, management expects the outlook to include continued growth in revenue and improved operating results in fiscal 2000. The improvement is expected to result from a combination of internal growth, particularly as it relates to CD-ROM replication services, and from operating efficiencies in the Company's operations.

MANAGEMENT'S REPORT TO THE SHAREHOLDERS

The accompanying consolidated financial statements and all information in the Annual Report are the responsibility of management. The consolidated financial statements have been prepared by management in accordance with the accounting policies in the notes to the financial statements. When necessary, management has made informed judgements and estimates in accounting for transactions which were not complete at the balance sheet date. In the opinion of management, the financial statements have been prepared within acceptable limits of materiality, and are in accordance with Canadian generally accepted accounting principles appropriate in the circumstances. The financial information elsewhere in the Annual Report has been reviewed to ensure consistency with that in the consolidated financial statements.

Management maintains appropriate systems of internal control. Policies and procedures are designed to give reasonable assurance that transactions are properly authorized, assets are safeguarded and financial records properly maintained to provide reliable information for the preparation of financial statements.

KPMG, an independent firm of Chartered Accountants, was engaged, as approved by a vote of shareholders at the Corporation's most recent annual general meeting, to audit the consolidated financial statements in accordance with generally accepted auditing standards in Canada and provide an independent professional opinion.

The audit committee of the Board of Directors, which is comprised of four directors who are not employees in the Corporation, has discussed the consolidated financial statements, including the notes thereto, with management and external auditors. The consolidated financial statements have been approved by the Board of Directors on the recommendation of the audit committee.

Scott Lawrie

P. Scott Lawrie
Executive Vice President
October 5, 1999

P Fernandez

Paul Fernandez
Vice President, Finance
October 5, 1999

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheet of Q•Media Services Corporation as at July 31, 1999 and the consolidated statements of operations and deficit and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.
In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at July 31, 1999 and the results of its operations and its cash flows for the year then ended in accordance with generally accepted accounting principles. As required by the Company Act of British Columbia, we report that, in our opinion, these principles have been applied on a consistent basis.
The comparative figures were audited by another firm of chartered accountants.

KPMG LLP

Chartered Accountants
Richmond, Canada
September 24, 1999

CONSOLIDATED BALANCE SHEET

JULY 31, 1999 WITH COMPARATIVE FIGURES FOR 1998

(EXPRESSED IN THOUSANDS OF DOLLARS)	1999	1998
ASSETS		
Current assets		
Cash and cash equivalents	$ 293	$ 3,649
Accounts receivable	12,732	10,037
Inventories (note 5)	6,397	4,432
Prepaid expenses and deposits	2,587	1,024
	22,009	19,142
Capital assets (note 6)	9,923	9,368
Goodwill (note 7)	17,454	18,408
	$ 49,386	$ 46,918
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	$ 11,878	$ 11,884
Current portion of long-term debt (note 8)	1,966	1,979
	13,844	13,863
Long-term debt (note 8)	4,712	3,635
Convertible debentures (note 9)	9,111	8,893
Shareholders' equity		
Share capital (note 10)	23,400	22,735
Special warrants (note 10)	–	3,558
Convertible debentures (note 9)	1,226	1,226
Cumulative translation adjustment	1,669	2,085
Deficit	(4,576)	(9,077)
	21,719	20,527
Commitments and contingencies (notes 13 and 16)		
	$ 49,386	$ 46,918

See accompanying notes to consolidated financial statements.

On behalf of the Board

Robert M. Lawrie
Director

F. David D. Scott
Director

CONSOLIDATED STATEMENT OF OPERATIONS AND DEFICIT

YEAR ENDED JULY 31, 1999 WITH COMPARATIVE FIGURES FOR 1998

(EXPRESSED IN THOUSANDS OF DOLLARS, EXCEPT PER SHARE AMOUNTS)	1999	1998
Revenue	$ 101,843	$ 45,801
Cost of goods sold	75,207	31,629
	26,636	14,172
Expenses		
Selling	5,921	3,132
General and administrative	10,268	5,352
Amortization	2,949	1,894
Interest	1,339	557
	20,477	10,935
Earnings before undernoted	6,159	3,237
Write-down of goodwill and investment (note 4)	–	(8,143)
Earnings (loss) before income taxes	6,159	(4,906)
Income taxes (note 12)	1,658	31
Net earnings (loss)	4,501	(4,937)
Deficit, beginning of year	(9,077)	(4,140)
Deficit, end of year	$ (4,576)	$ (9,077)
Earnings (loss) per share (note 14)		
Basic	$ 0.43	$ (0.54)
Fully diluted	0.30	–

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

YEAR ENDED JULY 31, 1999 WITH COMPARATIVE FIGURES FOR 1998

(EXPRESSED IN THOUSANDS OF DOLLARS)	1999	1998
CASH PROVIDED BY (USED IN)		
Operating activities		
Net earnings (loss)	$ 4,501	$ (4,937)
Items not involving cash		
Amortization	2,949	1,894
Accretion of convertible debentures	218	119
Write-down of goodwill	–	7,763
Write-down of investment	–	380
Net change in non-cash working capital	(6,274)	548
	1,394	5,767
Financing activities		
Repayment of long-term debt	(2,069)	(1,330)
Redemption of special warrants	(2,869)	–
Increase in long-term debt	3,167	4,103
Share issue costs	(24)	(2,419)
Repurchase of common shares	–	(6,181)
Issue of common shares	–	12,606
Convertible debenture proceeds	–	10,000
	(1,795)	16,779
Investing activities		
Purchase of capital assets	(2,787)	(1,776)
Acquisitions, net of cash received	–	(18,039)
Advances to affiliate	–	(1)
Proceeds on disposal of capital assets	–	89
	(2,787)	(19,727)
Effect of foreign currency exchange rates on cash and cash equivalents	(168)	781
Increase (decrease) in cash and cash equivalents	(3,356)	3,600
Cash and cash equivalents, beginning of year	3,649	49
Cash and cash equivalents, end of year	$ 293	$ 3,649
Supplementary disclosure		
Cash paid for		
Interest	$ 1,284	$ 467
Income taxes	602	33

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JULY 31, 1999.
(EXPRESSED IN THOUSANDS OF DOLLARS, EXCEPT NUMBER OF SHARES AND PER SHARE AMOUNTS)

The Company was incorporated under the Company Act of British Columbia and is in the business of providing media replication, assembly, inventory management and order fulfillment services to the software industry.

1. SIGNIFICANT ACCOUNTING POLICIES

(a) **Principles of consolidation**

The consolidated financial statements include the accounts of the Company and all entities which are controlled by the Company, referred to as subsidiaries. The accounts of its subsidiaries are included from the date of acquisition. The effective interest of Q•Media Services Corporation in the voting equity share capital of all of its subsidiaries is 100%.

(b) **Use of estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including accounts receivable, inventories, capital assets and goodwill, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates used in the preparation of the financial statements.

(c) **Cash equivalents**

Cash equivalents include short-term deposits, which are all highly marketable securities with a maturity of three months or less when acquired. Short-term deposits are valued at cost.

(d) **Short-term investments**

Short-term investments, all of which are categorized as available for sale, are carried at the lower of cost and quoted market value.

(e) **Inventories**

Raw materials, work-in-process and finished goods are recorded at the lower of average cost and net realizable value.

(f) **Capital assets**

Capital assets are initially recorded at cost. Amortization is subsequently provided on the following assets using the straight-line method:

Production equipment	5 years
Furniture and fixtures	5 years
Office equipment	5 years

CD-ROM replication equipment is amortized on a per unit basis over the estimated life of the equipment not exceeding 12 years.

Leasehold improvements are amortized on a straight-line basis over the lease term.

(g) **Goodwill**

Goodwill represents the excess of acquisition consideration over the fair values of the net identifiable assets acquired and is amortized on a straight-line basis over the estimated lives over periods not exceeding 20 years. The Company evaluates the carrying value of goodwill for potential permanent impairment on an ongoing basis. In order to determine if such a permanent impairment exists, the Company's management considers each business unit's financial condition and projected future

earnings before tax. A permanent impairment in the value of goodwill is written off to earnings in the year such impairment is recognized.

(h) **Revenue recognition**
Revenue from sales of products and services is recognized upon the shipment of the product or rendering of the service to the customer.

(i) **Translation of foreign currencies**
Transactions in foreign currencies are translated into Canadian dollars at the exchange rates in effect on the transaction date. Monetary items expressed in foreign currencies are translated into Canadian dollars at the exchange rates in effect at the balance sheet date. The resulting exchange gains and losses are recognized in income.

Self-sustaining operations, which comprise all of the Company's subsidiaries, are those whose economic activities are largely independent of those of the parent company. The Company uses the current rate method to translate the accounts of its self-sustaining operations into Canadian dollars. Under this method, assets and liabilities are translated at the exchange rates in effect at the balance sheet date, and revenues and expenses are translated at average rates for the period. The unrealized translation gains and losses on the Company's net investment, including long-term intercompany advances, are accumulated in a separate component of shareholders' equity, described in the consolidated balance sheet as cumulative translation adjustment.

(j) **Share issue costs**
The costs of issuing common shares are applied to reduce the stated value of such shares.

(k) **Comparative figures**
Certain of the comparative figures have been reclassified to conform with the basis of presentation adopted in the current year.

2. ADOPTION OF NEW ACCOUNTING STANDARDS

(a) **Statement of cash flows**
In 1999, the Company adopted Canadian Institute of Chartered Accountants ("CICA") Section 1540, Cash Flow Statements, which generally results in the exclusion of non-cash transactions from the statement and requires them to be reported separately. Adoption of the new section has not otherwise impacted the measurement or recognition of transactions. As a result of the adoption of the cash flow statement, non-cash transactions excluded from the statement of cash flows for the year ended July 31, 1998 include special warrants of $3,558 and note payable of $3,051 issued on acquisition.

(b) **Segmented information**
In 1999, the Company adopted CICA Section 1701, Segment Disclosures, which modifies the definition of a reportable segment. Under this new section, segments correspond to the Company's internal organization structure rather than the industry and geographic areas of operations.

3. ACQUISITIONS

(a) **PAC Services, Inc. ("PAC")**

On November 30, 1997, the Company acquired 100% of the shares of PAC. The acquisition was accounted for using the purchase method of accounting and the results of operations have been consolidated since the date of the acquisition. The Company's interest in the net assets acquired at assigned values is as follows:

Current assets	$	7,034
Capital assets		3,212
Goodwill		11,391
Current liabilities		(5,741)
Long-term debt		(760)
Acquisition cost	$	15,136
Consideration		
Cash	$	11,578
1,423,200 special warrants		3,558
	$	15,136

The Company is contingently liable to pay up to US $3,000 in cash and shares in fiscal 2000 in the event that certain earnings targets are achieved. Any additional consideration will be recorded as an additional cost of the purchase at the date the consideration becomes determinable.

(b) **Supply Chain Management Division of Hart Graphics Inc. ("Hart Irvine")**

On July 6, 1998, the Company acquired the majority of assets and liabilities of Hart Irvine. The acquisition was accounted for using the purchase method of accounting and the results of operations have been consolidated since the date of acquisition. The Company's interest in the net assets acquired at assigned values is as follows:

Current assets	$	64
Capital assets		557
Goodwill		5,278
Current liabilities		(198)
Long-term debt		(293)
Acquisition cost	$	5,408
Consideration		
Cash	$	2,357
Note payable		3,051
	$	5,408

4. WRITE-DOWN OF GOODWILL AND INVESTMENT

(a) **Digimedia, Inc. ("Digimedia")**

Effective January 31, 1998, management determined the net book value of goodwill associated with Digimedia, totaling $7,763 as at January 31, 1998, should be written off to operations due to a pending sale of the major customer of this business. Without the continued revenue and earnings associated with this customer, management determined the operations of this business were permanently impaired. On July 6, 1998, the Company acquired this customer, Supply Chain Management Division of Hart Graphics Inc., and capitalized $5,278 of goodwill associated with the acquisition (note 3(b)).

(b) **Q•Test Technologies Ltd. ("Q•Test")**

The Company has written off the carrying value of its 19% investment in Q•Test, totaling $380.

5. INVENTORIES

		1999		1998
Raw materials	$	5,655	$	4,223
Work-in-process		31		103
Finished goods		711		106
	$	6,397	$	4,432

6. CAPITAL ASSETS

		Cost		Accumulated Amortization		1999 Net Book Value		1998 Net Book Value
CD-ROM replication equipment	$	4,455	$	270	$	4,185	$	3,378
Production equipment		12,994		10,330		2,664		3,698
Office furniture and equipment, fixtures and leasehold improvements		5,959		2,885		3,074		2,292
	$	23,408	$	13,485	$	9,923	$	9,368

At July 31, 1999, assets under capital leases with a cost of $2,989 (1998 - $457) and accumulated amortization of $1,379 (1998 - $289) are included in capital assets.

7. GOODWILL

		1999		1998
Goodwill	$	27,964	$	28,059
Less accumulated amortization		10,510		9,651
	$	17,454	$	18,408

8. LONG-TERM DEBT

	1999	1998
Loans from officers, bearing interest at bank prime plus 1/4%	$ –	$ 112
US $7 loan from an officer of a subsidiary, bearing interest at 10% if principal payments are in arrears, due August 1, 1998	–	11
US $2,000 term loan, interest at U.S. prime rate payable monthly, due November 30, 2000	3,024	–
US $2,000 promissory note payable in 36 equal monthly installments of US $56 plus interest at U.S. prime rate, adjusted quarterly, due June 30, 2001	2,016	3,051
US $192, non-interest bearing, unsecured and repayable at US $8 per month, due August 1, 2000	145	292
Capital lease obligations, bearing interest at 13%	1,493	2,148
	6,678	5,614
Less current portion	1,966	1,979
	$ 4,712	$ 3,635

As of July 31, 1999, future minimum payments are as follows:

	Long-term debt	Minimum payments under capital leases	Total
2000	$ 1,153	$ 919	$ 2,072
2001	4,032	663	4,695
2002	–	98	98
2003	–	7	7
	5,185	1,687	6,872
Less amount representing interest at 13%	–	194	194
	5,185	1,493	6,678
Less current portion	1,153	813	1,966
	$ 4,032	$ 680	$ 4,712

9. CONVERTIBLE DEBENTURES

During 1998, the Company issued convertible debentures with a face value of $10,000. These debentures bear interest at 5%, payable quarterly, and mature December 23, 2002. The debentures are redeemable at the option of the Company, after two years, if the single day trading price of the Company's shares exceeds $4.00 per share and the average daily trading volume is in excess of 15,000 shares for a period of 30 days. The debentures are convertible at the election of the holder, at any time, into voting or non-voting common shares at the rate of 425.53 common shares for each thousand dollar face value of the debentures. Gross proceeds of $10,000 were received. The estimated equity value of the conversion feature of the debentures of $1,226 has been included as a separate component of shareholders' equity. The equity component was calculated as the difference between the gross proceeds received by the Company and the discounted cash flow of repayments based on an annual rate of 8%, which is consistent with similar borrowings available to the Company, without conversion features. The remaining portion of $8,774 was classified as a long-term liability. The debt component is being accreted to its face value at maturity over the term of the debt through a charge to interest expense.

10. SHARE CAPITAL

(a) **Authorized**

200,000,000 Voting common shares, without par value.

100,000,000 Non-voting common shares, without par value, convertible into voting shares on a 1:1 basis at the option of the holder.

(b) **Issued and outstanding**

	1999		1998	
	Shares	Amount	Shares	Amount
Voting common shares				
Outstanding, beginning of year	7,919,705	$ 18,089	7,348,707	$ 18,729
Exercise of warrants	273,466	689	–	–
Issued for cash from employee share plan	–	–	20,000	60
Issued pursuant to private placements	–	–	2,983,988	6,790
Redemption of common shares	–	–	(2,432,990)	(6,181)
Less share issue costs	–	(24)	–	(1,309)
Outstanding, end of year	8,193,171	18,754	7,919,705	18,089
Non-voting common shares				
Outstanding, beginning of year	2,528,778	4,646	–	–
Issued pursuant to private placements	–	–	2,528,778	5,756
Less share issue costs	–	–	–	(1,110)
Outstanding, end of year	2,528,778	4,646	2,528,778	4,646
Total share capital	10,721,949	$ 23,400	10,448,483	$ 22,735

(c) **Stock option plan**

The Company has reserved 1,580,000 common shares for future issuance under its stock option plan. The plan provides for the granting of options at the fair market value of the Company's stock at the grant date.

Stock option activity for 1999 and 1998 is presented below:

	1999		1998	
	Number	Price Range	Number	Price Range
Outstanding, beginning of year	800,100	$2.00 - $5.00	244,000	$2.15 - $5.00
Granted	534,800	$1.90 - $2.46	635,400	$2.00 - $2.70
Forfeited	101,500	$2.35 - $5.00	59,300	$2.35 - $4.35
Exercised	–	–	20,000	$3.00
Outstanding, end of year	1,233,400	$1.90 - $3.55	800,100	$2.00 - $5.00

The options outstanding at July 31, 1999 expire between August 12, 1999 and November 18, 2008.

(d) **Warrants**

As part of the private placement and convertible debenture financing in 1998, the Company issued 750,000 warrants. Each warrant entitles the holder to purchase one common share at a price of $2.90 per share, expiring December 22, 1999.

(e) **Special warrants**

The Company issued 1,423,200 special warrants in connection with the acquisition of PAC Services, Inc. (note 3). On March 5, 1999, 1,149,734 of these warrants were redeemed by the Company for an amount of US $2,000 and 273,466 were converted to common shares at no additional cost.

11. FINANCIAL INSTRUMENTS

(a) **Fair values**

The carrying amounts of cash and cash equivalents, accounts receivable, deposits, and accounts payable and accrued liabilities approximate fair value due to their short maturities. Based on the borrowing rates currently available to the Company for loans with similar terms, the carrying values of its long-term debt, capital lease obligations and convertible debentures approximate fair value.

(b) **Concentrations of credit risk**

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash equivalents and trade receivables. The Company places its cash equivalents in high quality financial institutions in the countries in which it operates. To mitigate credit risk, the Company performs ongoing credit evaluations of its customers. The Company provides reserves for potential credit losses and such losses and yearly provisions have not been significant and have been within management's expectations.

(c) **Foreign exchange**

The Company operates internationally, which gives rise to a risk that its earnings and cash flows may be negatively impacted by fluctuations in interest and foreign exchange rates.

(d) **Interest rate risk**

The Company is subject to interest rate risk on its floating rate US $2,000 promissory note payable and its US $2,000 term loan.

(e) **Line of credit**

The Company has a US $8,000 unused line of credit with U.S. Bank, bearing interest at U.S. bank prime rate secured by a first charge on receivables and inventory of all U.S.-based operations.

12. INCOME TAXES

Income tax expense varies from the amount that would be computed by applying the Canadian federal and provincial statutory tax rate of 38.6% to earnings (loss) before income taxes as shown in the following table:

		1999		1998
Combined Canadian federal and provincial income taxes at expected rate	$	2,377	$	(1,906)
Reduction of income taxes from use of unrecorded tax benefits		(849)		(461)
Permanent and other differences		130		2,398
	$	1,658	$	31

The Company has taxable timing differences in Canada and the United States, being the excess net book values of combined capital and other assets over their tax values which are offset by loss and other carry-forwards and balances of approximately $2,500 which expire commencing 2001. The Company also has $1,700 of financing costs which are deductible evenly over the next three years.

The potential tax benefits that may arise from these net amounts have not been recognized in these financial statements.

13. COMMITMENTS

The Company has entered into various operating lease agreements, with remaining terms of up to five years, for office premises and equipment. The minimum lease payments in each of the next five years are approximately as follows:

2000	$	4,544
2001		4,283
2002		4,204
2003		3,618
2004 and thereafter		4,080

14. EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share is calculated based upon the weighted average number of voting and non-voting common shares outstanding during the year, which was 10,559,368 (1998 - 9,083,159).

Fully diluted earnings per share reflects the dilutive effect of the conversion of the stock options, warrants and convertible debentures outstanding at the end of the year or those items exercised or converted during the year, as if they had been exercised or converted at the beginning of the year or the date issued, if later. The number of shares used for the calculation of the fully diluted earnings per share is 17,486,119.

Interest on the funds which would have been received had the options and warrants been exercised, in the amount of $280 net of income tax, has been imputed at a rate of 5.4% per annum. Fully diluted earnings excludes $500 of interest net of taxes upon the assumed conversion of convertible debentures to common shares at the beginning of the period.

In 1998, the full exercise and conversion of stock options, warrants and convertible debentures is anti-dilutive and consequently loss per share on a fully dilutive share basis has not been presented.

15. SEGMENTED INFORMATION

The Company operates in the computer software products industry and all sales of its products and services are made in this segment. Management of the Company makes decisions about allocating resources based on the one operating segment.

The Company conducts its operations in Canada and the United States. Information by geographic area is as follows:

	Year ended July 31, 1999		Year ended July 31, 1998	
	Revenues	Capital assets and goodwill	Revenues	Capital assets and goodwill
United States	$ 97,773	$ 26,917	$ 43,330	$ 27,481
Canada	4,070	460	2,471	295
Total	$ 101,843	$ 27,377	$ 45,801	$ 27,776

Revenues are attributed to countries based on location of the distribution branch.

Significant customers

The approximate sales to significant customers are as follows:

	1999	1998
One customer	$ 37,008	$ –

16. UNCERTAINTY DUE TO THE YEAR 2000 ISSUE

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

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